



ARIZONA STATE RETIREMENT SYSTEM

3300 NORTH CENTRAL AVENUE • PO BOX 33910 • PHOENIX, AZ 85067-3910 • PHONE (602) 240-2000

7660 EAST BROADWAY BOULEVARD • SUITE 108 • TUCSON, AZ 85710-3776 • PHONE (520) 239-3100

TOLL FREE OUTSIDE METRO PHOENIX AND TUCSON 1 (800) 621-3778

EMAIL ADDRESS: ASKMAC@AZASRS.GOV • WEB ADDRESS: WWW.AZASRS.GOV

Paul Matson
Director

MINUTES PUBLIC MEETING ARIZONA STATE RETIREMENT SYSTEM BOARD

Friday, July 16, 2010
8:30 A.M., MST

The Arizona State Retirement System (ASRS) Board met in the 10th Floor Board Room, 3300 N. Central Avenue, Phoenix, Arizona. Mr. David Byers, Chair of the ASRS Board, called the meeting to order at 8:35 A.M., MST.

The meeting was teleconferenced to the ASRS office at 7660 E. Broadway, Tucson, Arizona 85710.

1. Call to Order; Roll Call; Opening Remarks

Present: Mr. David Byers, Chair
Mr. Tom Connelly, Vice-chair
Mr. Chris Harris
Professor Dennis Hoffman
Mr. Kevin McCarthy
Mr. Tom Manos
Mr. Larry Trachtenberg (arrived at 8:41 A.M.)
Mr. Steve Zeman

Absent: Mr. Michael Townsend

A quorum was present for the purpose of conducting business.

2. Presentation Regarding PRIDE Award for Improvement

Mr. Paul Matson, Director, presented the PRIDE Award for Improvement to the Benefits Accounting Team (Erica Dunphy, Tom Emerson, Jeannette Lopez, Angel Soliman, Calandra Johnson, Carrie Waith, Teresa Escoto, Peggy Smith, Maria Hockaday, Vanessa Estrada, Dan Haney, Mary Lopez, Phillip Verver, Darren Taylor, Don Crockett, Maria Baltag, Nicie Montanez). They were nominated by their peers because they exemplify the following PRIDE qualities of improvement: *"I am continuously growing and learning. I embrace new ideas. I am a critical thinker who offers innovative solutions."*

3. Approval of the Minutes of the May 21, 2010 Public Meeting and Executive Session of the ASRS Board

Motion: Mr. Steve Zeman moved to approve the minutes of the May 21, 2010 Public Meeting and Executive Session of the ASRS Board.

Mr. Tom Connelly seconded the motion.

By a vote of 7 in favor, 0 opposed, 0 abstentions, and 2 excused, the motion was approved.

4. Approval, Modification, or Rejection of Recommended Administrative Law Judge's Decision Regarding Ms. Slava Satell

Mr. Larry Trachtenberg arrived.

Mr. Patrick Klein, Assistant Director, External Affairs, gave the Board a brief explanation of the LTD benefit program and gave an overview of Ms. Slava Satell's LTD appeal. Ms. Satell was an employee at the Arizona Department of Environmental Quality. She became disabled on November 15, 2000, and began receiving ASRS long-term disability payments in 2001. Ms. Satell's LTD benefits were not reduced by her social security disability benefits, resulting in an overpayment of LTD benefits in the amount of \$7,366.47. Ms. Satell's LTD benefits were not reduced by her workers compensation benefits, resulting in an overpayment of LTD benefits in the amount of \$26,589.66. The ASRS has collected \$2,389.07 from Ms. Satell. The remaining overpayment balance is \$31,567.06.

Mr. Klein noted, in September 2002, Ms. Satell informed Sedgwick that she was awarded both Social Security benefits and workers' compensation benefits, but she never provided copies of the awards or detailed information on the benefit amounts and dates. Sedgwick learned in April 2003, from the Arizona Department of Administration that Ms. Satell received workers' compensation benefits in 2002. Sedgwick learned in November 2003, from a Social Security Administration document, that Ms. Satell had begun receiving Social Security disability in May 2001. Ms. Satell retired from the ASRS in May 2004. Between 2004 and 2009, the ASRS LTD claims administrators, VPA and Sedgwick, and ASRS Financial Services staff attempted to collect the overpayment in benefits to Ms. Satell. In March 2010, Ms. Satell filed an appeal with the ASRS and requested an administrative hearing.

Mr. Klein explained that Administrative Law Judge Brian Tully, in his Recommended Decision dated May 18, 2010, upheld the ASRS Director's determination that Ms. Satell received an overpayment of ASRS LTD benefits in the amount of \$31,567.06.

Ms. Satell asserted her benefits cannot be reduced by law, since they were paid in a lump sum. Mr. Klein said A.R.S. § 38-711 does not apply to an LTD benefit situation but refers to vacation or sick leave lump sum payments as they relate to the determination of retirement benefits. He said it does not apply to the lump sum benefit Ms. Satell received from Social Security or workers' compensation for disability.

Motion: Mr. Larry Trachtenberg moved to accept the ruling of the Administrative Law Judge to uphold the Director's determination that ASRS member Ms. Slava Satell received an overpayment of long-term disability (LTD) benefits in the amount of \$31,567.06;

And

the Director be authorized to approve a repayment schedule that the Director feels would be beneficial to Ms. Satell.

Mr. Steve Zeman seconded the motion.

By a vote of 8 in favor, 0 opposed, 0 abstentions, and 1 excused, the motion was approved.

5. Presentation, Discussion and Appropriate Action Regarding the ASRS Total Fund Performance Review for the Period Ending 3/31/10

Mr. Gary Dokes, Chief Investment Officer; Mr. David Underwood, Equity Portfolio Manager; and Mr. Allan Martin, Partner; New England Pension Consultants, addressed the Board regarding the ASRS Total Fund Performance Review for the Period Ending 3/31/10, highlighting specific areas of interest and concern.

The Total Fund Performance for the period ending March 31, 2010 is:

	Quarter	9 months	1 Year	3 Years	5 Years	10 Years	Since Inception (6/30/75)
Total Fund	4.2%	22.8%	37.7%	-1.1%	4.0%	2.8%	9.9%
SAA Benchmark	4.0%	21.5%	38.4%	-0.7%	4.2%	2.4%	9.7%
Excess Return	0.2%	1.3%	-0.7%	-0.4%	-0.2%	0.4%	0.2%

Note:

1. Strategic Asset Allocation Policy Benchmark: 28% S&P 500/6% S&P 400/6% S&P 600/24% Barclays Capital Aggregate/2% Barclays Capital High Yield/13% MSCI EAFE/2% MSCI EAFE Small Cap/3% MSCI Emerging Markets/6% NCREIF Property Index + 100 bps (lagged one quarter)/7% Russell 3000 + 300 bps/3% Commodities

2. Interim Benchmark*: 35% S&P 500, 7% S&P 400, 7% S&P 600, 19% MSCI ACWI ex-U.S., 27% Barclays Capital Aggregate, 4% NCREIF Property Index + 100 bps (lagged one quarter), and 1% Russell 3000 + 300 bps

* Interim Benchmark prorates unfunded policy portion of Real Estate to other policy asset classes; prorates Private Equity, and Inflation-Linked to U.S. equities.

6. Presentation, Discussion and Appropriate Action Regarding the Budget Request for 2012/2013

Mr. Matson and Mr. Russ Levine, Administrative Services Officer, addressed the Board regarding the Budget Request for Fiscal Years 2012/2013.

Mr. Levine explained major plans and projects to modernize ASRS services and functions concluded in FY 09 and consequently, the budget request for FY 12/13 has been structured to continue the transition of the agency from a period of high development activity into a more structured work environment. The modest request will supplement a stable, permanent staffing infrastructure and maintain and enhance the agency's technology.

Mr. Levine said to accomplish this, staff and the Operations Committee are recommending an additional nine permanent positions (seven to begin in FY 12 and two to begin in FY 13), to manage and facilitate asset class extensions within the Board-approved ASRS Asset Allocation Policy and to provide targeted, strategic support in the ASRS Technology and Member Services areas. Staff believes the FY 12/13 budget request represents a reasonable and cost effective utilization of Plan assets. The significant investment in modernizing operations since FY 02 is on track to ensure the agency's overall long-term efficiency and effectiveness. The FY 12/13 request supports and continues that effort.

Mr. Levine noted, in addition to its human resources, staff and the OC are recommending additional funding for travel, other operating expenses, equipment, and professional outside services, such as risk management.

Motion: Mr. Steve Zeman moved to approve an appropriated budget request for Fiscal Year 2012 in the amount of \$24,441,900;

And

Approve a budget request for Fiscal Year 2013 in the amount of \$24,434,700 with a possible change in each Fiscal Year due to insurance rates for ADOA Risk Management.

Mr. Tom Connelly seconded the motion.

By a vote of 8 in favor, 0 opposed, 0 abstentions, and 1 excused, the motion was approved.

7. Presentation, Discussion and Appropriate Action Regarding an Implementation Plan for the Hybrid System pursuant to the Attorney General's Opinion

Mr. Matson and Ms. Sara Orozco, Strategic Planning Manager, addressed the Board regarding an Implementation Plan for the Hybrid System pursuant to the Attorney General's Opinion. Ms. Orozco noted the following nine key decisions resulting from this opinion and presented corresponding staff recommendations:

Question #1: Should the Board accept the legal opinion of the Attorney General?

Staff Recommendation:

None. This question was resolved at the December 18, 2009 Board meeting.

Question #2: Is the System, in effect, now a Defined Benefit Plan? If so, what are the ramifications?

Staff Recommendation:

Staff recommends the ASRS continue to refer to the System as a hybrid defined contribution plan, making modifications only to items impacted by the attorney general opinion.

Question #3: Are the Plan (and the State), obligated to fund the liabilities of the System?

Staff Recommendation:

Staff recommends that System liabilities be funded in the following manner:

1. All assets and liabilities attributable to System members with a **retirement date on or after July 1, 1981** should be allocated to the Plan and included in the determination Annual Required Contribution (ARC) for the Plan.
2. All assets and liabilities attributable to System members **with contributions on account but without a vested benefit** who are eligible only for a refund of contributions should be allocated to the Plan and included in the determination of the Annual Required Contribution (ARC) for the Plan.
3. The funded portion of the liabilities attributable to System members with a **retirement date prior to July 1, 1981** should be allocated to the Plan and included in the determination of the Annual Required Contribution (ARC) for the Plan.
4. The unfunded portion of the liabilities for System members with a **retirement date prior to July 1, 1981** will not be allocated to the Plan and will be excluded from the determination of the Annual Required Contribution (ARC) for the Plan. Staff will communicate this liability to the State, which will determine whether and how the liability will be funded.

Mr. Matson explained the ASRS will be required to account for System liabilities as though they are guaranteed, in accordance with GASB 25 and 27 rules for defined benefit plans. A request was made to discuss GASB at the September Board meeting.

Question #4: How will Plan (and State) contributions be determined?

Staff Recommendation:

Staff recommends that:

1. Contributions for the Plan and the State should be determined based upon the allocation outlined in Question #3.
2. Plan assumptions should be used for all members incorporated into the Plan valuation as outlined in Question #3.
3. The unfunded portion of any liabilities attributable to System members with a retirement date prior to July 1, 1981, should be excluded from the Plan valuation as outlined in Question #3.
4. The ASRS should continue to perform a yearly valuation specific to the System as a whole

that uses assumptions specific to the System membership.

Question #5: How many groups of System members are there, and do they need to be accounted for separately?

Staff Recommendation:

Staff recommends that System members be separated and accounted for according to the following groupings:

- A. System members (those who retired before July 1, 1981).
- B. Plan members with rights to a System benefit (System members who retired on or after July 1, 1981, when the law transferred all non-retired System members into the Plan, but allowed the members to retain their rights to a System benefit).
- C. Plan members with rights only to receive a refund of their remaining unvested System account balances (a.k.a. green bar accounts).

Staff further recommends that System assets be allocated to each group based on the percent of liabilities funded in each group, as determined by the System valuation.

Question #6: What process will the agency use in the future to determine when System members will receive an increase to their 13th check?

Staff Recommendation:

Staff recommends that the ASRS utilize the methodology developed with Buck Consultants as described in the System Decisions Recommendations, Attachment A, as presented to the Board, that will gradually reduce investment risk as the funded status increases.

Question #7: If an overfunded status exists when each of the groups identified have only one remaining member or have no remaining members, how will it be handled?

Staff Recommendation:

Staff recommends that any residual assets in any of the three groups of System members that have been identified first be used to increase the funded status of the other groups.

In the event that residual funds are on account when there are no remaining System members, staff recommends that:

- Any residual balance remaining from System members who retired before July 1, 1981 (group A) should be paid to the State, up to an amount provided by the State to the ASRS to cover any unfunded liability associated with this group. Any remaining balance should revert to the Plan.
- Any residual balance remaining from Plan members with rights to a System benefit, and Plan members with rights to only receive a refund of their unvested System account balances (groups B and C) should revert to the Plan.

Question #8: Are multiple asset allocations required for the different groups? Should any adjustments be made to the asset allocation of the System?

Staff Recommendation:

Staff recommends that the System continue to have one uniform asset allocation for all System assets. Staff further recommends that the allocation recognize the duration of System liabilities, the level of risk appropriate for System members, and the characteristics of the System and its relationship to the Plan.

Question #9: What are the agency's obligations and plan of action with regard to the administrative rules already in place?

Staff Recommendation:

None required as this is a status update.

Mr. Matson provided the Board a status update. There are currently seven Administrative Rules related to the System. Staff's review indicated that most of the rules need to be repealed. As part of the five-year review process required by the Governor's Regulatory Review Council (GRRRC), the ASRS identified which System rules should remain, and which should be allowed to expire. Staff has made the following determinations, and included them in its submission for the five-year review:

- R2-8-201 provides definitions for the System rules
 - Staff recommended that this rule remain, and be amended as required.
- R2-8-202 covers actuarial assumptions
 - Staff elected not to review this rule and allow the rule to expire.
- R2-8-203 thru R2-8-205 detail when and how to reduce System member benefits
 - Staff elected not to review these rules and allow the rules to expire.
- R2-8-206 covers benefit and account increases
 - Staff elected not to review this rule and allow the rule to expire. Staff will review and determine if a new rule is required and follow-up with the EAC and Board at a later date.
- R2-8-207 details forfeiting contributions from the System
 - Staff recommended that this rule remain, and be amended as required.

Motion: Mr. Steve Zeman moved to approve the Implementation Plan for the Hybrid System as presented in Attachment A.

Professor Dennis Hoffman seconded the motion.

By a vote of 8 in favor, 0 opposed, 0 abstentions, and 1 excused, the motion was approved.

8. Presentation, Discussion and Appropriate Action Regarding Opportunistic Private Investments

Mr. Matson addressed the Board regarding Opportunistic Private Investments. Mr. Gary R. Dokes, Chief Investment Officer, and Mr. Richard Henkel, Private Equity (PE) Portfolio Manager, were present as subject matter experts. Meketa, the ASRS PE consultant, and Townsend Group, the ASRS Real Estate consultant, were present via telephone.

Mr. Matson said, during 2008, the ASRS instituted Asset Class Committees to expedite decision making and consolidate expertise in four functional areas: real estate; private equities; public markets; opportunistic investments. To better capture private market investment opportunities, the ASRS should consider increasing its resource allocation in the area of Opportunistic Private Investments (OPIs).

Mr. Matson outlined four thematic investment areas, listed in probable order of engagement, which currently constitute the universe of OPIs:

- Emerging Firms with Experienced Personnel
- Direct /Co-Investment Analysis
- Regional Expertise
- Direct Partnership Structures

Mr. Matson explained, the logic of the investment thesis of OPIs consists of:

- Investment Opportunities (the ability to make tactical decisions)
- Diversification

- Better Terms
- Better Alignment of Interest

Mr. Matson said, if the Board approves OPIs, the Director will develop a hiring committee possibly consisting of the Board Chair, IC Chair, Director, CIO, and HR Manager to hire a staff Portfolio Manager. One of the first key assignments of the staff Portfolio Manager would be to present a Strategic Plan to the IC. Once the IC accepts the OPI Strategic Plan, the PEC, REC, and OIC would be authorized to proceed with including OPIs in their current mandates.

Mr. Chris Harris said he originally had some concerns when OPI was presented at the IC meeting, and voted against it, but the proposed changes Mr. Matson has incorporated over the past several weeks have significantly addressed his concerns. Mr. Harris said he felt comfortable with proceeding with OPIs. He said the Board should be aware that emerging managers and regional managers in OPIs may open the door to political influence. The Board may need to update governance to be prepared for that.

Motion: Mr. Tom Connelly moved to approve the inclusion of Opportunistic Private Investments (OPIs) in the current opportunity-sets for the Real Estate Committee, Private Equity Committee, and Opportunistic Investment Committee according to the broad parameters outlined in the presented memo and chart.

Professor Dennis Hoffman seconded the motion.

By a vote of 8 in favor, 0 opposed, 0 abstentions, and 1 excused, the motion was approved.

9. Director's Report

Mr. Matson presented the Director's Report. He noted there were no compliance violations found through the internal audit process. He said GASB preliminary views will be an agenda topic at the September Board meeting.

Mr. Matson said the ASRS has a health insurance contract ending December 31, 2010. The next plan year begins January 2011. Staff is conducting significant analysis in anticipation of negotiation of that contract renewal. The ASRS health insurance plan year is now aligned with the Arizona Department of Administration (ADOA) plan year for active employees. ADOA has moved from a non-calendar year to a calendar year, beginning this year, so 2011 will now be a calendar plan year for active employees' health insurance. The plan year is now calendar year for both DOA retirees, active, and the ASRS.

Mr. Matson complimented ADOA for accomplishing this, stating it would benefit members and ADOA did an outstanding job moving ahead on this.

Mr. Matson also pointed out the ASRS has aligned the ASRS open enrollment period to be the same as ADOA's, with one exception. The ASRS is adding an extra week at the front end of the open enrollment period. The ASRS has also agreed to have joint participation in ADOA health insurance rollout meetings. Mr. Matson said ADOA is investigating whether they can have the 457 plan provided there as well, for convenient "one stop shopping." Mr. Matson said ADOA has done a terrific job working with the ASRS.

Mr. Matson stated that a very rough preliminary estimate of the fund's rate of return for the period ending June 30, 2010, is 14 percent. The fiscal year to date rate of return since June 30, 2010, is approximately estimated at three percent as of the end of July.

10. Possible Presentation Regarding Board Committee Updates

Mr. Patrick Klein, Assistant Director, External Affairs, said the next External Affairs Committee meeting will take place October 1, 2010 at 10:00 A.M. Legislative initiatives for 2011 will be discussed.

Mr. Tom Connelly, Chair, Investment Committee (IC), said the next IC meeting will take place August 16, 2010 at 2:30 P.M. The IC will discuss how the Investment Policy Statement encompasses the operation of the Asset Class Committees and relates to investment decisions.

Mr. Steve Zeman, Chair, Operations Committee (OC), said the next OC meeting will take place August 26, 2010 at 10:30 A.M. The OC will discuss the IT project review and the Continuity of Operations Plan.

11. New Agenda Items

Earlier in the meeting, a request was made to add GASB as an informational item at the September meeting. No other requests were made.

12. Call to the Public

No members of the public requested to speak.

13. The next ASRS Board meeting is scheduled for Friday, September 3, 2010, at 8:30 A.M., at 3300 N. Central Avenue, 10th Floor Board room, Phoenix, Arizona.

14. Adjournment of the ASRS Board

Mr. Byers adjourned the Board meeting at 11:46 A.M.

ARIZONA STATE RETIREMENT SYSTEM

Lisa Hanneman
Board Secretary

Date

Paul Matson
Director

Date